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FISCAL IMPACT STATEMENT

LS 7109

BILL NUMBER: SB 444

NOTE PREPARED: Jan 7, 2004

BILL AMENDED:

SUBJECT: Military Income Tax Deduction.

FIRST AUTHOR: Sen. Mrvan

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill provides an Income Tax deduction for all income, including retirement or survivor's benefits, derived from service in the armed forces in Afghanistan or Iraq, for taxable years beginning after December 31, 2002, and ending before January 1, 2008.

Effective Date: January 1, 2003 (retroactive).

Explanation of State Expenditures: The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate this deduction. These expenses presumably could be absorbed given the DOR's existing budget and resources. Under the bill, the deduction is effective beginning in tax year 2003. However, the deduction for tax year 2003 will have to be claimed in 2004 as 2003 tax forms have already been published and distributed. Tax year 2004 tax forms will have to be revised to include the deduction for both 2003 and 2004.

Explanation of State Revenues: The bill would reduce state Adjusted Gross Income (AGI) Tax liabilities of individual taxpayers who serve in the military in Afghanistan or Iraq, and whose income earned from military service exceeds \$2,000. The deduction is applicable for tax years 2003 to 2007. The revenue loss due to this bill could potentially total about \$1.3 M in FY 2005. As 2003 tax forms do not provide for this deduction, the 2003 and 2004 deductions would have to be claimed in tax year 2004. Thus, the fiscal impact in FY 2005 is a combination of two years of deductions (an estimated \$642,000 each year). This assumes a similar incidence of Indiana residents serving in the military in Afghanistan and Iraq during 2003 and 2004.

Background: The bill provides for a deduction from AGI of all income in excess of the current \$2,000 military deduction received during the taxable year, for service in Afghanistan or Iraq. The deduction could

be claimed for such income earned in tax years 2003 through 2007. This deduction could be claimed by a qualifying taxpayer in addition to the existing \$2,000 maximum allowable deduction for military service pay.

According to the Defense Manpower Data Center, 2,499 enlisted personnel and 147 officers (including warrant officers) reporting Indiana as their state of residence to the Internal Revenue Service served outside the U.S. and its territories during the first 9 months of 2003. Annualized taxable income paid to these individuals totaled about \$50.3 M. It is estimated that approximately \$5.3 M of this income would be deductible under the current \$2,000 military service pay deduction. Thus, the net deduction for all Indiana residents serving in the military outside the U.S. and its territories during 2003 is estimated to total about \$45.0 M. Based on active duty strength levels by region reported by the U.S. Department of Defense, it is estimated that about 42% of the overseas military personnel are serving in and around Iraq. Strength levels in Afghanistan are not available. Assuming 42% of the Indiana residents serving overseas are serving in Iraq, the deduction amount for these individuals could potentially total about \$18.9 M. The tax impact of the deduction amount would be approximately \$642,000. The fiscal impact could fall above or below this total to the extent that personnel overseas are serving in Afghanistan or don't serve for the entire year in either Iraq or Afghanistan.

The revenue from the AGI Tax on individuals is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%).

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the proposed deduction would serve to decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) may, as a result, experience an indeterminable decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: Deborah Williamson, Defense Manpower Data Center, 831-583-2400. U.S. Department of Defense, *Active Duty Military Personnel Strengths by Regional Area and By Country (309A)*, September 30, 2003, <http://web1.whs.osd.mil/mmid/mmidhome.htm>.

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